EX PARTE OR LATE FILED

MCI Communications Corporation
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MCI

Donald F. Evans
Director
Federal Regulatory Affairs

[redacted]

ORIGINAL

January 3, 1995

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: EX-PARTE, CC Docket 94-1

Dear Mr. Caton:

In accordance with the Commission's Rules governing EX-PARTE communications, be advised that today I met with Karen Brinkman. We discussed MCI's position in the above captioned proceeding and I provided a financial analysis of cash flow. The attached documents were used in our presentation.

Please place a copy of this notice and the attached documents in the record of the above captioned proceeding.

Sincerely,

Donald F. Evans

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Operating Cash Flow Analysis

December 1994

Operating Cash Flow Analysis

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IXCs

	1993
Net Revenue	$63.5B
Market Capitalization (estimated)	$ 60.4B
Operating Cash Flow (EBITDA)	$12.1B
EBITDA Margin	19.0%

RBOCs

	1993
Net Revenue	$71.3B
Market Capitalization	$148.6B
Operating Cash Flow (EBITDA)	$32.8B
EBITDA Margin	46.0%

	Net Revenue	EBITDA	EBITDA Margin	% of Total
Local	$34.2B	$7.5B	22.0%	23.0%
Access	$20.8B	$\boxed{\$14.7B}$	70.7%	$\boxed{44.8\%}$
Toll	$ 9.7B	$6.4B	66.1%	19.6%
Misc.	$6.6B	$4.1B	63.0%	12.6%
Total	$71.3B	$32.8B	46.0%	100%

Notes:

1). Sources: FCC Preliminary Statistics of Communication Common Carriers for year ended December 31, 1993; FCC Report 4303; FCC Report 4302; 1993 Business Week 1000; Company Annual Reports and 10Ks. The compilation of the underlying RBOC FCC data was verified by Price Waterhouse LLP. RBOC net revenue excludes wireless.

2). The IXC industry composite is comprised of MCI, LDDS, ALC, LCI, AT&T long distance services and Sprint long distance.

3). The market capitalization for AT&T and Sprint has been estimated based on long distance operating income as a percentage of total Company long distance operating income.

Access charges generate $4.4B in free cash flow to fund dividend payments and investment in new ventures.

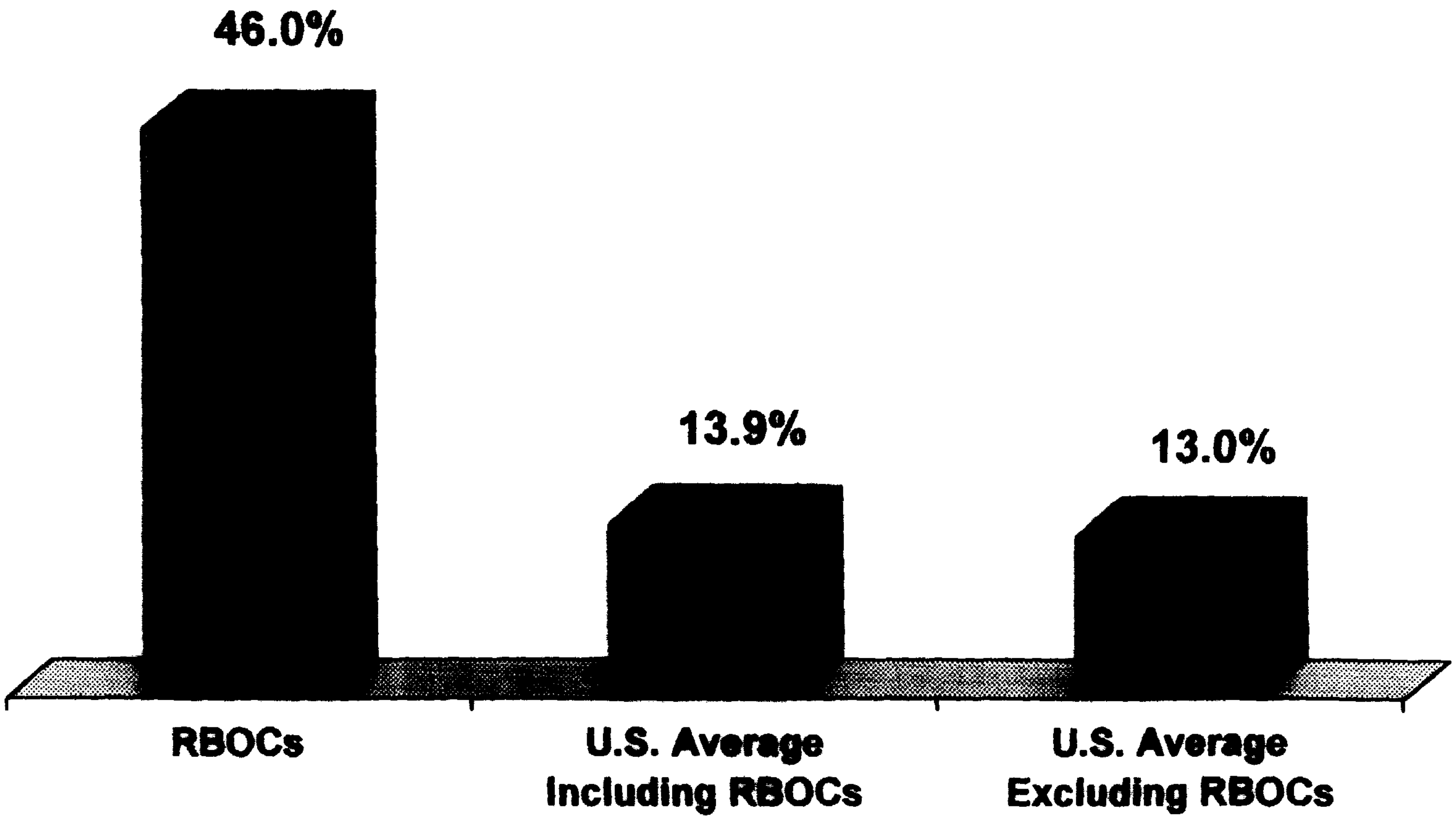
	1993
Net access charges received by RBOCs	$20.8B
Operating Cash Flow (EBITDA) margin on access charges	x 70.7%
Operating Cash Flow (EBITDA) on access charges	$14.7B
Amount reinvestment in local plant (reinvestment rate is 44.5% on EBITDA)	$6.5B
Net interest expense (estimated rate is 9.6% on EBITDA)	$1.4B
Accrued taxes (estimated taxes rate is 16.5% on EBITDA)	$2.4B
Available for dividends and investment in new ventures	$4.4B

Notes:

1). Sources: See Page 1, Note 1.

2). During the period 1991 through 1993, $15B was invested in new ventures. Only $1.7B was capitalized through external funding.

1993 EBITDA Comparison



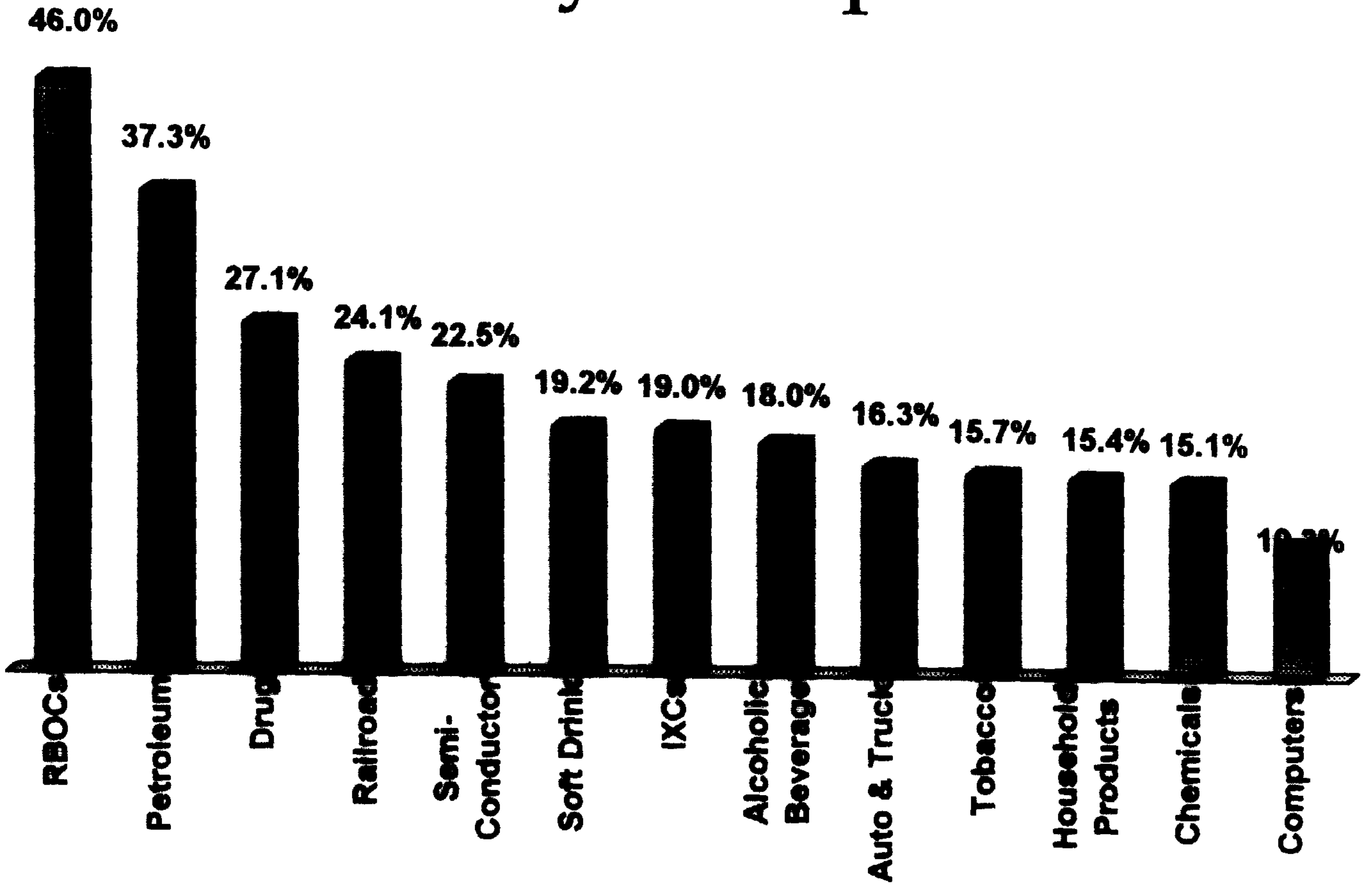
Notes:

1). Sources: Disclosure, Inc. for U.S. Average. For RBOCs, see Page 1, Note 1.

2). U.S. average is comprised of all companies who produce goods and services, who file financial statements with the SEC, and who had 1993 revenues exceeding $10 billion.

3). The Disclosure, Inc data has been adjusted based on additional information.

1993 EBITDA
Industry Comparison



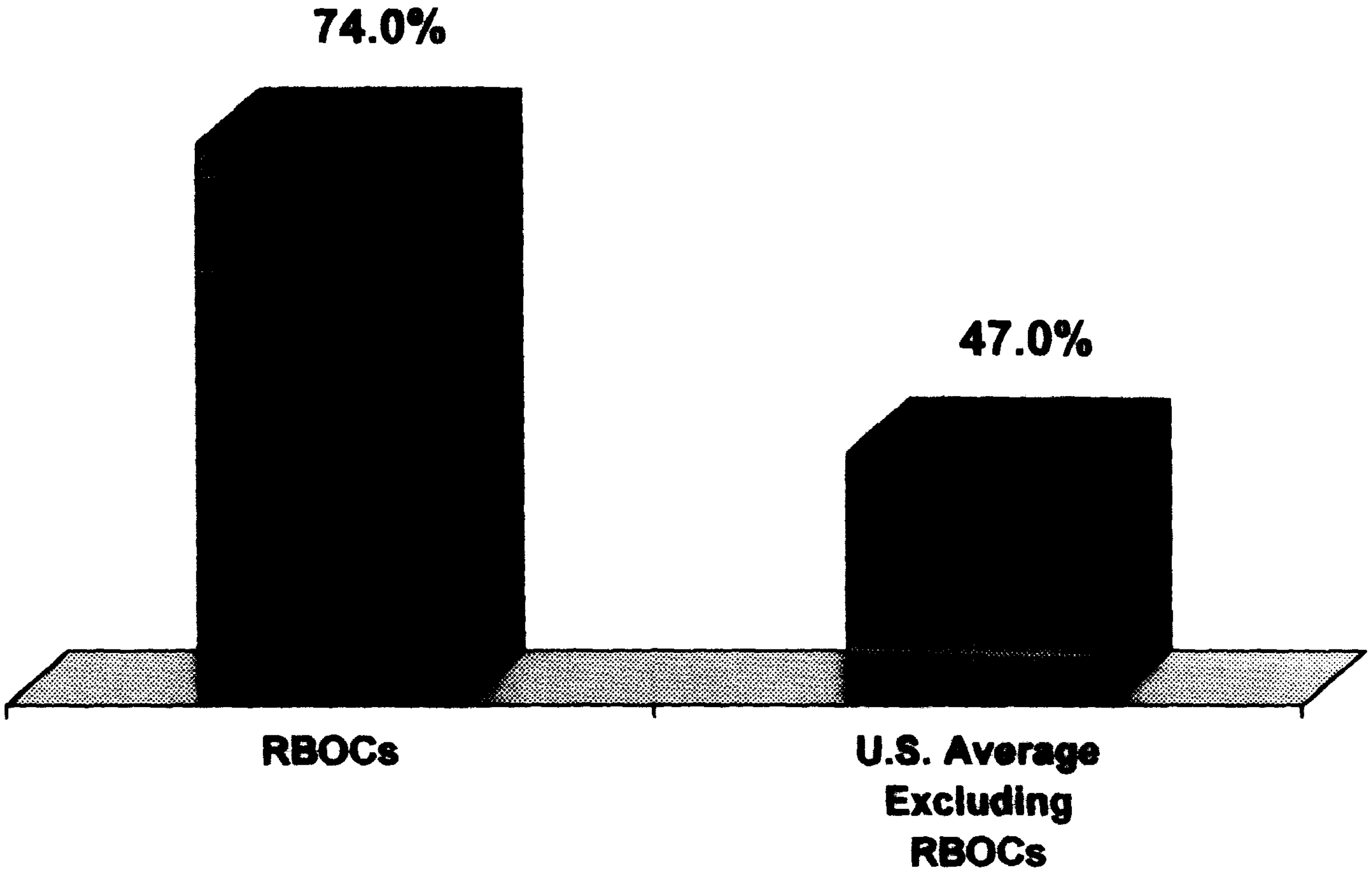
<u>Sources:</u>

1). RBOCs: See Page 1, Note 1.

2). IXCs: See Page 1, Notes 1 & 2.

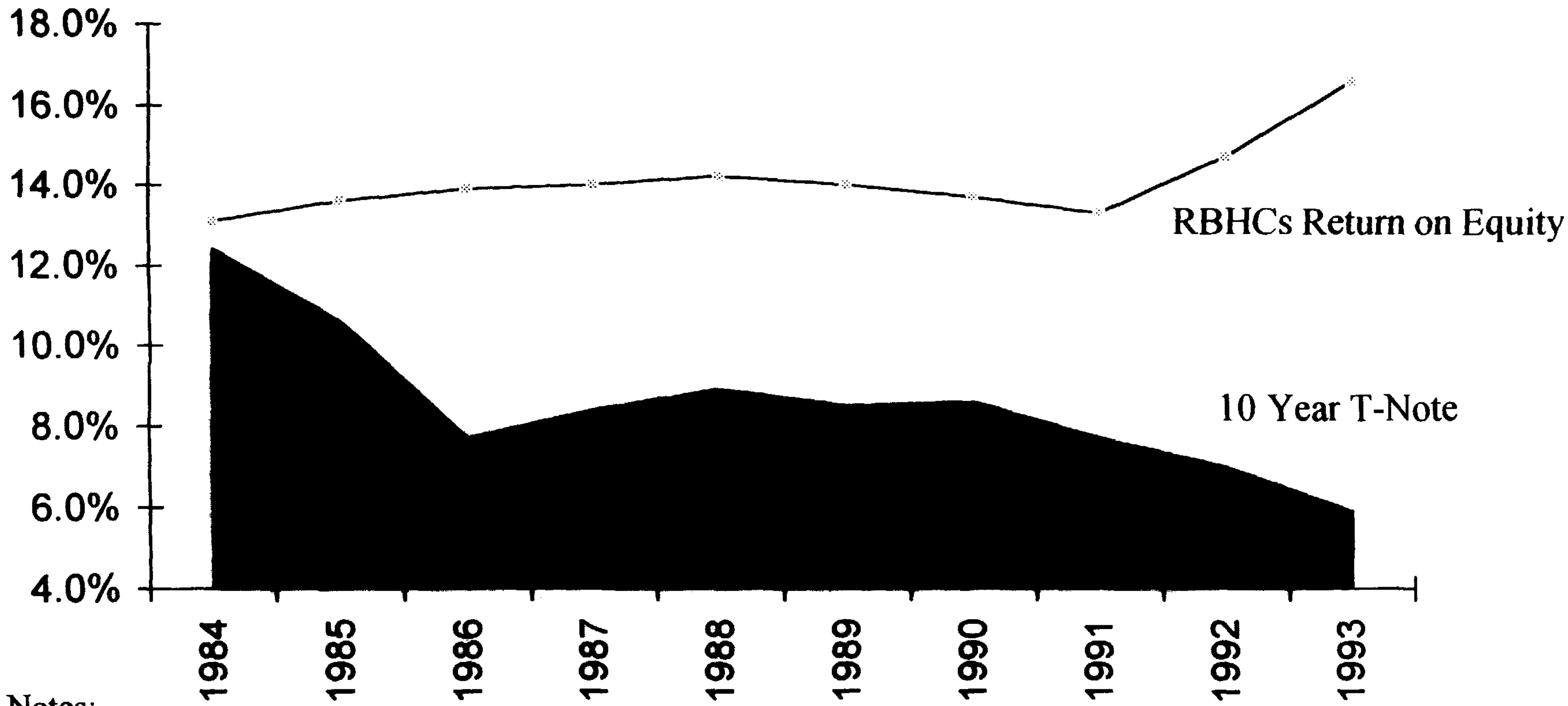
3). All Other Industries: <u>The Value Line Investment Survey</u> - 1994 Editions.

1993 Dividend Payout



<u>Notes:</u>
1). Sources: Disclosure, Inc.
2). U.S. average is comprised Fortune 500 companies who had 1993 revenues exceeding $5 billion.
3). Dividend Payout is dividends divided by income before taxes.

Return on Equity
RBHCs Versus the 10 Year T-Note



Notes:

1). Source: Company Annual Reports.

2). Rate of Return is computed from net income excluding the effects of accounting changes and other one-time charges.

IXCs

	1993
Net Revenue	$63.5B
Market Capitalization (estimated)	$60.4B
Operating Cash Flow (EBITDA)	$12.1B
EBITDA Margin	19.0%

All LECs Including RBOCs

	1993
Net Revenue	$90.2B
Market Capitalization (estimated)	$196.0B
Operating Cash Flow (EBITDA)	$41.7B
EBITDA Margin	46.2%

	Net Revenue	EBITDA	EBITDA Margin	% of Total
Local	$41.2B	$9.1B	22.0%	21.4%
Access	$27.0B	$19.1B	70.7%	44.9%
Toll	$ 12.9B	$8.5B	66.1%	20.1%
Misc.	$9.2B	$5.8B	63.0%	13.6%

Notes:

1). Sources: See Page 1, Note 1.

2). The IXC industry composite is comprised of MCI, LDDS, ALC, LCI, AT&T long distance services and Sprint long distance.

3). The market capitalization for AT&Tand Sprint has been estimated based on long distance operating income as a percentage of total Company long distance operating income.

4). The EBITDA margin by business line for all LECs is based on the margins derived for the RBOCs. When these ratios are multiplied by net revenue to estimate the EBITDA by business line, the sum is higher than the total EBITDA of $41.7B. The non-RBOC LECs have a different revenue mix than the RBOCs.

Access charges generate $5.6B in free cash flow to fund dividend payments and investment in new ventures.

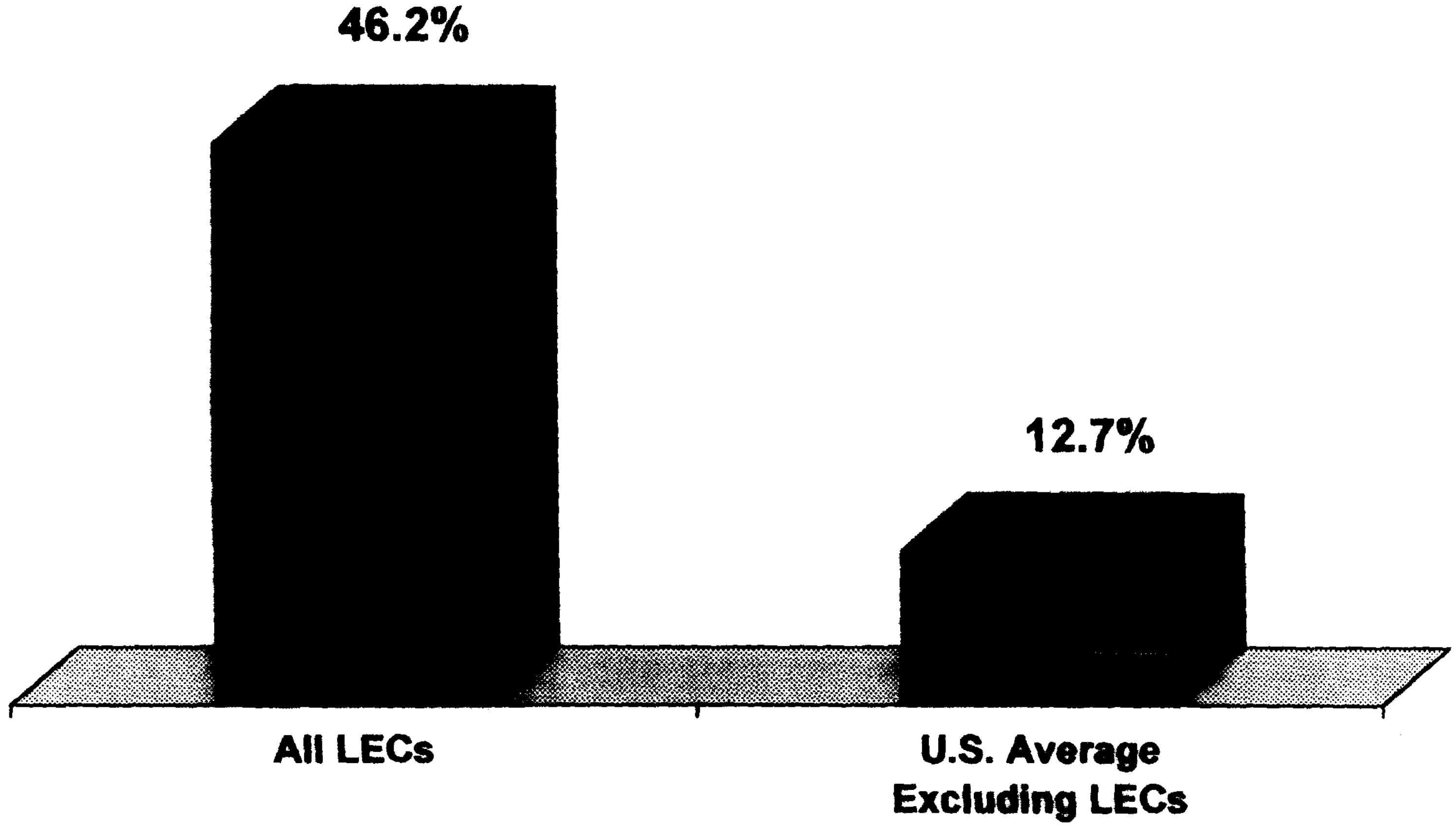
	1993
Net access charges received by all LECs including RBOCs	$27.0B
Operating Cash Flow (EBITDA) margin on access charges	x 70.7%
Operating Cash Flow (EBITDA) on access charges	$19.1B
Amount reinvestment in local plant (reinvestment rate is 44.5% on EBITDA)	$8.5B
Net interest expense (estimated rate is 9.6% on EBITDA)	$1.8B
Accrued taxes (estimated rate is 16.5% on EBITDA)	$3.2B
Available for dividends and investment in new ventures	$5.6B

Note:

1). Sources: See Page 1, Note 1.

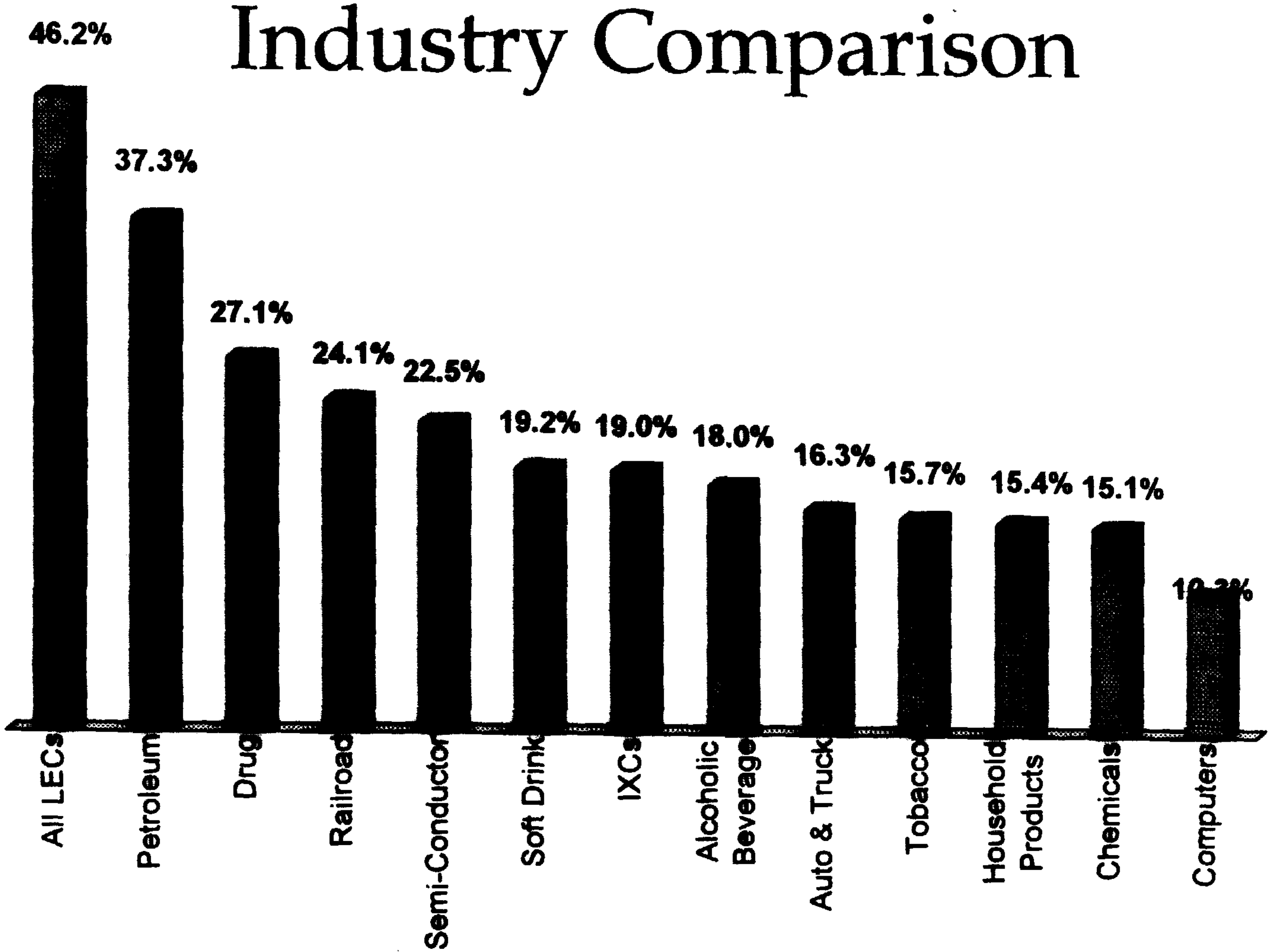
2). Reinvestment rate, interest paid rate and effective tax rate are based on rates derived for the RBOCs.

1993 EBITDA Comparison



Notes:
1). Sources: Disclosure, Inc. for U.S. Average. For all LECs, see Page 1, Note 1.
2). U.S. average is comprised of all companies who produce goods and services, who file financial statements with the SEC, and who had 1993 revenues exceeding $10 billion.

1993 EBITDA
Industry Comparison



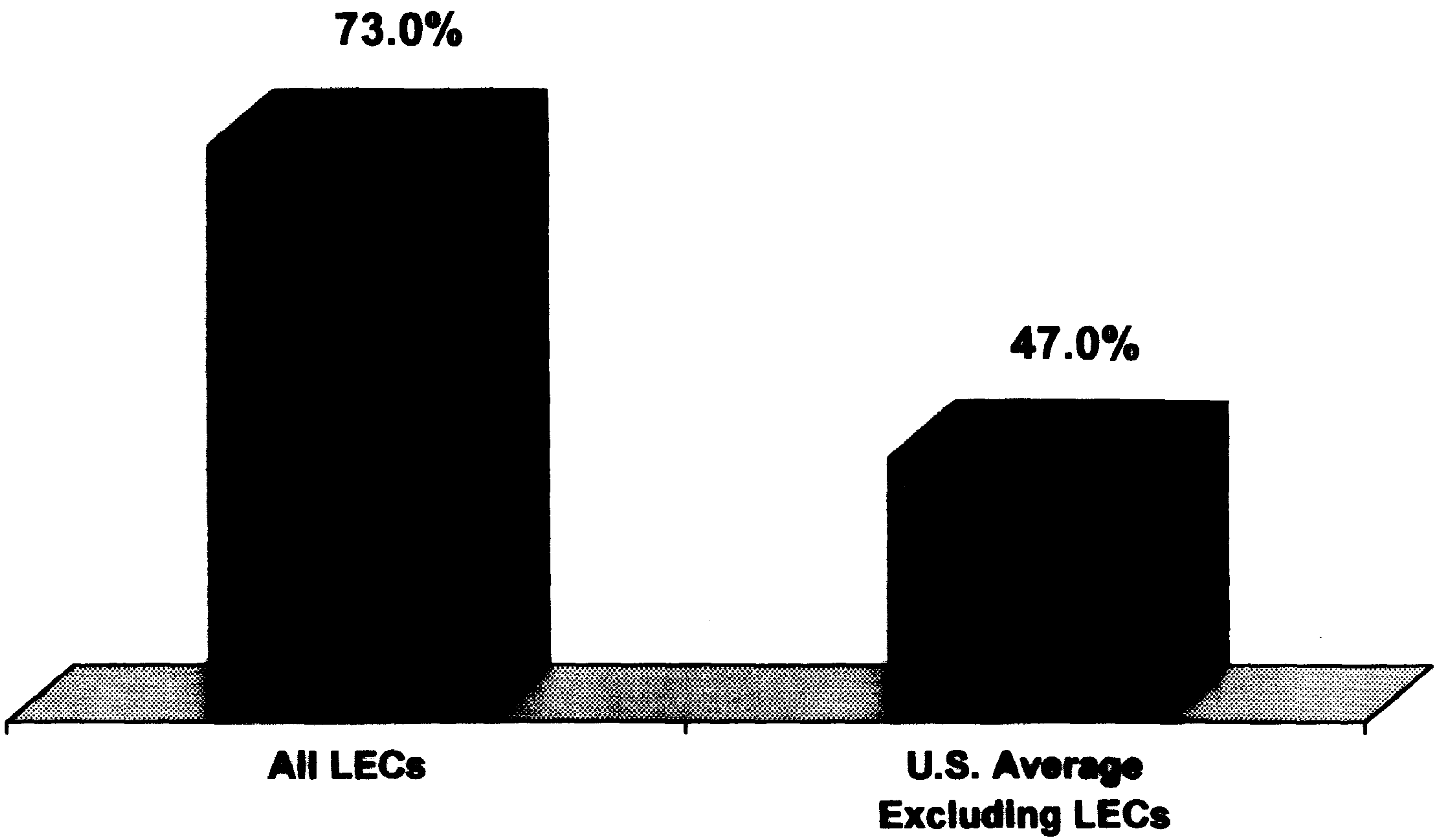
<u>Sources:</u>

1). All LECs: See Page 1, Note 1.

2). IXCs: See Page 1, Notes 1 & 2.

3). All Other Industries: <u>The Value Line Investment Survey</u> - 1994 Editions.

1993 Dividend Payout



Notes:
1). Source: Disclosure, Inc. and Company Annual Reports.
2). U.S. average is comprised of Fortune 500 companies who had 1993 revenues exceeding $5 billion.
3). Dividend Payout is dividends divided by income before taxes.

Attachments

PERFORMANCE REVIEW

- The Commission noted that the Performance Review would reconsider all aspects of the price cap plan

> "The transition from rate of return to price cap regulation is a complex one, and, while we have made every effort to consider each relevant factor carefully and to base our determinations in reason and experience, some fine–tuning will probably prove necessary."
>
> LEC Price Cap Order, para. 385

> "The performance review should provide sufficient information to allow the Commission to reevaluate the need for lower end adjustment and sharing mechanisms, and to adjust the sharing mechanism and productivity factor if necessary. At that time, we will evaluate all aspects of the price cap plan and of LEC performance."
>
> LEC Price Cap Order, para. 394

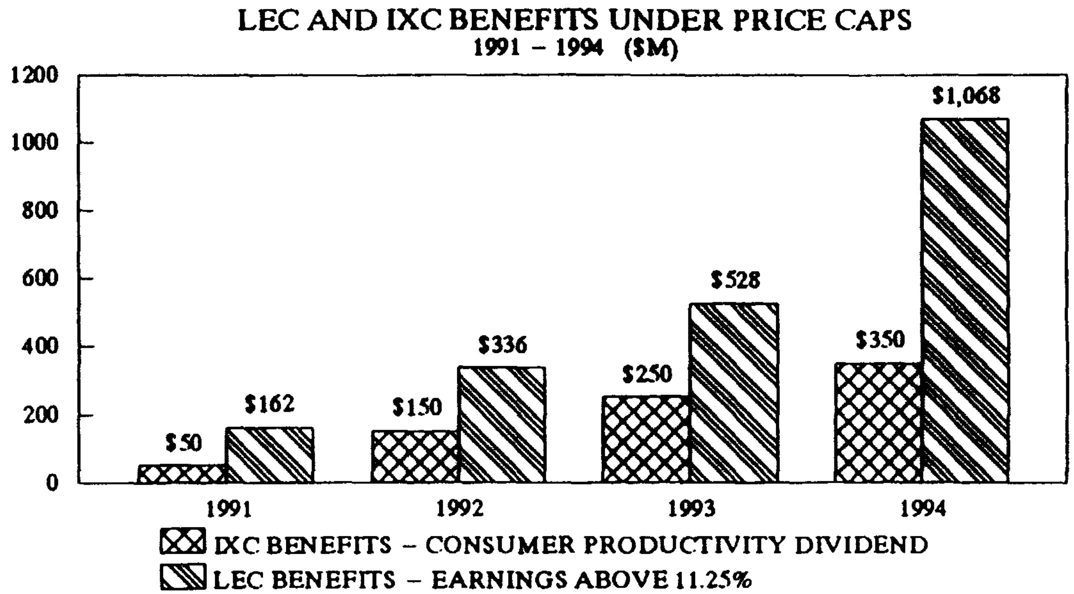
- Recalibration of the productivity factor or the sharing mechanism does not destroy price cap incentives

LEC WINDFALLS

- Half the growth in CCL minutes of use
- No recalibration of TS Switching rates when the trunking basket was created
- Cost of capital dropped early in the price cap period
- Many unplanned exogenous changes

BENEFITS OF PRICE CAPS

- Benefits of price caps have been overly skewed toward the LECs
- The value to LECs of earnings above 11.25% has exceeded the benefit to the IXCs of the 0.5% Consumer Productivity Dividend



NEEDED CHANGES TO THE PRICE CAP PLAN

- Increase the productivity factor
- Recalibrate rates to reflect lower cost of capital
- Limit future exogenous changes
- Retain sharing

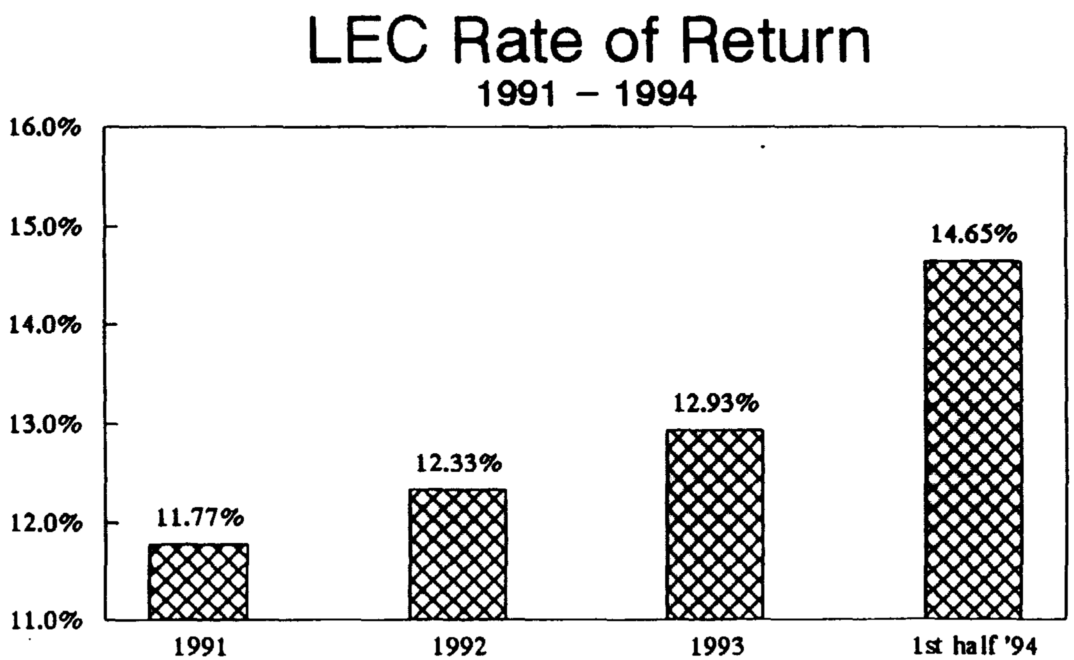
PRODUCTIVITY

- Productivity factor should be increased
- Commission's original choice of productivity factor was a "conservative minimum figure"

LEC Price Cap Order, para. 99.

PRODUCTIVITY (cont'd.)

- LEC earnings have consistently risen under price caps



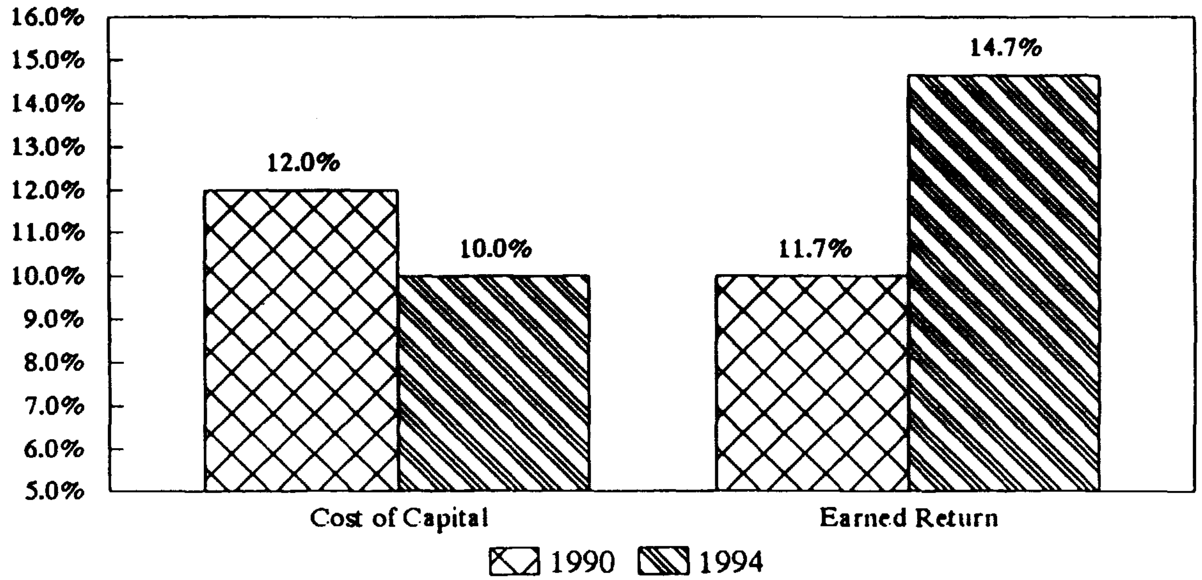
PRODUCTIVITY (cont'd.)

- An X of 5.9% would be consistent with both the original short–term study and the LECs' performance under price caps

RATE OF RETURN

- Cost of capital has declined since 1990, while earned returns have risen

Changes in Cost of Capital and Earned Return
1990 to 1994

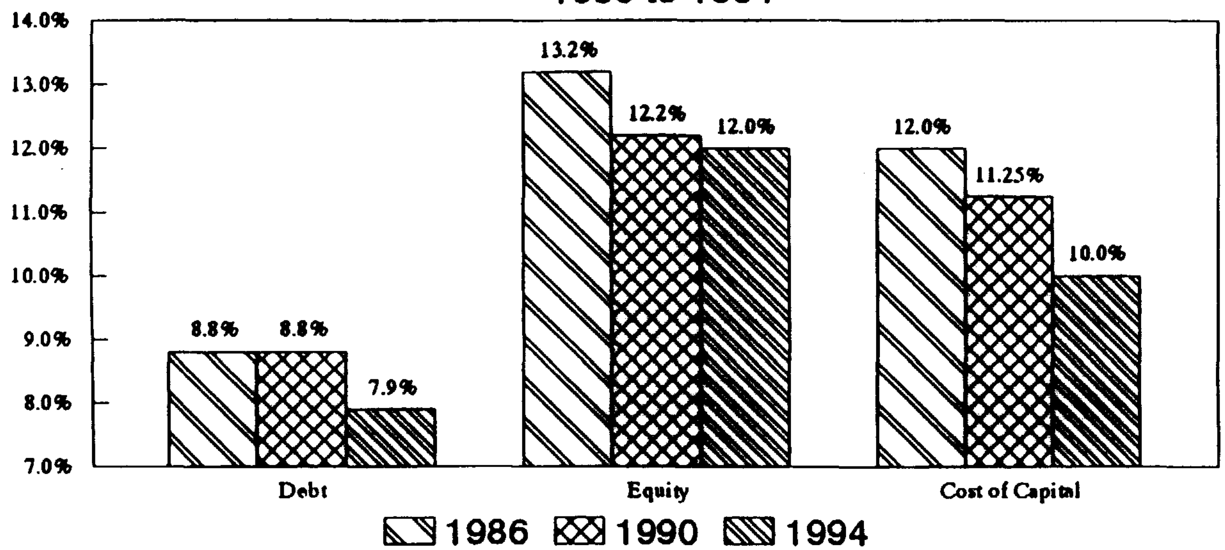


RATE OF RETURN (cont'd.)

- Updating the Commission's 1990 methodology with data through July 1994, the current cost of capital is 10 percent

LEC CAPITAL COSTS

1986 to 1994



RATE OF RETURN (cont'd.)

- Rate of Return changes are not captured in GNPPI – X, because X was set based on studies which held the rate of return constant

- In a competitive industry, firms do not retain reduced costs of capital forever; eventually they must pass through those reduced costs into lower prices